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## "No-Prejudice" No More: New York and the Death of the No-Prejudice Rule

Eric Tausend

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# “No-Prejudice” No More: New York and the Death of the No-Prejudice Rule

ERIC TAUSEND\*

*States differ in how they treat situations where an insured has not timely notified its insurer after an accident, claim, or loss. While the majority of states apply the “notice-prejudice” rule (which requires an insurer to show that the late notice prejudiced it before it can disclaim coverage), a minority of states apply the common law “no-prejudice” rule, which allows an insurer to disclaim coverage after late notice, regardless of whether it has been prejudiced. Until recently, New York State was one of the most zealous adherents to the no-prejudice rule, rigidly applying it and ignoring the often inequitable results. However, recently passed legislation has changed New York’s approach to late notice and brought it closer to the majority position by requiring the use of the notice-prejudice rule in liability policies.*

*This Note examines the various approaches that states use to address late notice, with a particular focus on late notice in New York and the recent change in New York’s law. New York occupies a uniquely influential position on insurance practices. As a result, New York’s abandonment of the no-prejudice rule is likely to have an impact far beyond its borders. While the recent legislation is certainly a step in the right direction, this Note argues that it contains a number of provisions, which may prove to be problematic, and provides suggestions as to how courts should interpret them. Specifically, these provisions are: (1) the law’s limited application to liability policies only, (2) how the law allocates the burden of showing prejudice, (3) the law’s definition of prejudice, and (4) potential retroactive application of the law.*

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## INTRODUCTION

Nearly every insurance policy contains a notice provision detailing how and when notice of a claim or loss is to be provided to an insurer.<sup>1</sup> Typically written, notice provisions create a duty for the insured.<sup>2</sup> For instance, a common notice provision in liability policies requires the insured to notify the insurer of any occurrence, accident, claim, or suit that may expose the insured to liability or that may impose upon the insurer a duty to defend or indemnify its insured.<sup>3</sup>

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1. ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 599–600 (4th ed. 2007).

2. 22 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 2D, § 139.1 (2003); JERRY & RICHMOND, *supra* note 1, at 601; 1 NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE § 9.07–9.09 (Jeffrey E. Thomas et al. eds., 2008).

3. To illustrate, the Insurance Services Office Inc.'s 1992 Commercial General Liability Coverage Form provides:

2. Duties in The Event Of Occurrence, Offense, Claim or Suit.

a. You must see to it that we are notified as soon as practicable of an "occurrence" or an offense which may result in a claim. . . .

. . . .

b. If a claim is made or "suit" is brought against any insured, you must:

. . . .

The notice provision serves numerous purposes;<sup>4</sup> however, the rationale courts and commentators most often cite is that providing prompt and timely notice to the insurer allows the insurer to conduct a thorough investigation of the underlying claims in order to prevent fraud, promptly settle claims, and mount an effective defense when dealing with liability policies.<sup>5</sup> As a thorough investigation is often contingent on receipt of prompt notice, most policies require notice "as soon as practicable," "as soon as possible," or "immediately" after a loss, accident, claim, or suit.<sup>6</sup> Despite the apparent differences in these timing requirements, courts generally interpret these provisions to simply require notice *within a reasonable amount of time*.<sup>7</sup> Accordingly, the focus of this Note is how courts treat situations where notice to the insurer is not provided within a reasonable amount of time.

At first blush, the notice provision might not seem like much more than a standard contractual provision that the parties are generally free to ignore with impunity. However, notice provisions have a deceptively large bite—or at least they once did. Under the common law, and still in a minority of jurisdictions today, an insured's unexcused failure to comply with a policy's notice provision—by failing to provide notice to the insurer within a reasonable amount of time—results in a complete forfeiture of coverage.<sup>8</sup> The common-law rule is now generally referred to as the "no-prejudice" rule because, under this rule, the insurer does not need to show that it was prejudiced by the late notice for it to deny coverage under the policy.<sup>9</sup>

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2. Notify us as soon as practicable.

You must see to it that we receive written notice of the claim or "suit" as soon as practicable.

1 SUSAN J. MILLER & PHILIP LEFEBVRE, MILLER'S STANDARD INSURANCE POLICIES ANNOTATED 415 (4th ed. 1995).

4. 22 HOLMES, *supra* note 2, § 139.2; 13 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3D, § 186:14 (1999); *see also* Unigard Sec. Ins. Co. v. N. River Ins. Co., 594 N.E.2d 571, 573 (N.Y. 1992) (discussing the various purposes of the notice provision in the context of New York State law).

5. *See, e.g.*, Commercial Union Ins. Co. v. Int'l Flavors & Fragrances, Inc., 822 F.2d 267, 271 (2d Cir. 1987); Vt. Mut. Ins. Co. v. Singleton, 446 S.E.2d 417, 421 (S.C. 1994) ("The purpose of a notification requirement is to allow for investigation of the facts and to assist the insurer in preparing a defense." (citing Washington v. Nat'l Serv. Fire Ins. Co., 168 S.E.2d 90, 93 (S.C. 1969))); JERRY & RICHMOND, *supra* note 1, at 600.

6. 22 HOLMES, *supra* note 2, § 139.3(A)(3)(a), (c); JERRY & RICHMOND, *supra* note 1, at 602.

7. *See, e.g.*, 875 Forest Ave. Corp. v. Aetna Cas. & Sur. Co., 322 N.Y.S.2d 53, 55–56 (App. Div. 1971); *see also* 22 HOLMES, *supra* note 2, § 139.3 (noting that most courts utilize the standard of "within a reasonable time"); JERRY & RICHMOND, *supra* note 1, at 602 (same).

8. 13 RUSS & SEGALLA, *supra* note 4, § 193:32; Eugene R. Anderson et al., *Draconian Forfeitures of Insurance: Commonplace, Indefensible, and Unnecessary*, 65 FORDHAM L. REV. 825, 836 (1996).

9. 13 RUSS & SEGALLA, *supra* note 4, § 193:32; *see also* JERRY & RICHMOND, *supra* note 1, at 605–07 (discussing the distinction between the traditional and modern rules).

In contrast, the modern trend and now the majority position is to use the “notice-prejudice” rule.<sup>10</sup> Under the notice-prejudice rule, late notice alone is insufficient for an insurer to deny coverage.<sup>11</sup> Rather, to deny coverage in most states applying the notice-prejudice rule, the insurer must show that it was somehow prejudiced by the late notice from the insured.<sup>12</sup>

For years, New York strictly applied the common law, no-prejudice rule and refused to acknowledge its inequitable results.<sup>13</sup> New York State’s unparalleled impact on the insurance industry makes its law particularly important.<sup>14</sup> The state of New York is “one of the principal insurance marketplaces of the world.”<sup>15</sup> Today most insurance is purchased through brokers and “[f]our of the five largest insurance brokers in the world have their corporate headquarters in New York.”<sup>16</sup> Even more telling, New York State is an extremely large purchaser of insurance, representing “approximately 7.38% of the property/casualty market in the United States, . . . approximately 9.12% of the life insurance and annuity [market] and 10.1% of the accident and health insurance markets . . . .”<sup>17</sup> Additionally, New York insurance law can be and is applied extraterritorially.<sup>18</sup> As a result, the insurance law of New York is critically important not only to the citizens and corporations of New York, but also to the insurance industry as a whole and to other states looking for guidance.

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10. JERRY & RICHMOND, *supra* note 1, at 607–08.

11. *Id.*

12. *Id.*

13. See Howard B. Epstein & Theodore A. Keyes, *New Late Notice Law Requires Insurers to Show Prejudice*, N.Y.L.J., Jan. 2, 2009, at 3, available at <http://www.srz.com/news/list.aspx?Professionals=cd58e436-3f80-4c93-af7d-6fd9fcbb5758>.

14. According to a New York State economic development agency, “New York State is the location of choice for the most important players in the worldwide insurance industry,” and the state is home to “[o]ver 7,200 insurance companies employ[ing] nearly 150,000” individuals. Insurance, Industry Clusters, Empire State Development, [http://www.empire.state.ny.us/NYS\\_Home\\_To\\_Business/Industry\\_Clusters/insurance.asp](http://www.empire.state.ny.us/NYS_Home_To_Business/Industry_Clusters/insurance.asp) (last visited Nov. 17, 2009); see also Jonathan R. Macey & Geoffrey P. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role of Insurance Regulation*, 68 N.Y.U. L. REV. 13, 73 (1993) (“New York [is] a major insurance market and home to many of the largest insurance firms . . .”).

15. 1 WOLCOTT B. DUNHAM, JR., *NEW YORK INSURANCE LAW* § 1.02 (2009).

16. *Id.*

17. *Id.* New York State’s share of the U.S. property/casualty insurance market is typically greater than its 6.4% share of the U.S. population. See *id.*

18. *Id.* § 1.03; see also Lynda A. Bennett & Andrew S. Zimmerman, *The End of New York’s Draconian Late Notice Law, Perhaps*, N.J. STATE BAR ASS’N, INS. L. SECTION, Sept. 1, 2008, at 16, available at [http://www.rfbclaw.com/upload/082008102956Article-The\\_End\\_of\\_Draconian.pdf](http://www.rfbclaw.com/upload/082008102956Article-The_End_of_Draconian.pdf) (discussing how New Jersey insurance carriers are enamored with the New York law); 1 DUNHAM, *supra* note 15, § 1.01 (“Other jurisdictions often look to [New York’s] insurance laws and court decisions for guidance.”); *id.* § 1.03 (discussing the extraterritorial application of New York insurance law, and the use of New York insurance law as a model for other states).

New York's once-strict application of the no-prejudice rule led to countless insureds being left without coverage for seemingly insignificant delays.<sup>19</sup> For years, calls for the judiciary to reverse course and adopt the majority rule went unanswered.<sup>20</sup> Ultimately, change would not come until the summer of 2008 when the New York Legislature and Governor brought about the modernization of New York insurance law.<sup>21</sup>

With the quick flick of a pen on July 21, 2008, New York Governor David Paterson signed chapter 388 into law,<sup>22</sup> rocking the New York insurance industry and instantly erasing years of New York jurisprudence.<sup>23</sup> Chapter 388 amended section 3420 of the New York Insurance Law so as to statutorily adopt the notice-prejudice rule in all liability policies issued after January 17, 2009.<sup>24</sup> Significantly, the law abandons New York's long-held position that the no-prejudice rule applies to late-notice situations, and requires the adoption of the notice-prejudice rule.<sup>25</sup>

This law is a tremendous change for the State of New York. New York is now more in line with the majority of states, and the decision to adopt the notice-prejudice rule should have extraterritorial effects in other states. It is quite likely that other states that have been applying the no-prejudice rule will follow New York's lead and similarly abandon the rule. Thus, this action may mark the beginning of the end for the no-prejudice rule. Thanks to New York, the no-prejudice rule may soon be relegated to life solely in the pages of insurance treatises and history books.

Yet questions remain as to the effectiveness of the New York law and the effect of the provisions within it. Part I of this Note examines the different approaches to late notice, the history of late notice in New York, past judiciary and statutory efforts to change the law, and the recent and dramatic change in the treatment of late notice through the passage of the legislation signed by Governor Paterson. Part II more closely surveys the new law, and discusses the implications of its provisions, the likely issues that will arise from them, and how best to deal with these issues in the future.

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19. See *infra* notes 35–41 and accompanying text.

20. See *infra* Part I.B (discussing the history of the no-prejudice rule in New York).

21. See Peter Molinaro, "No-Prejudice Rule" Abolished, *INS. ADVOC.*, Oct. 20, 2008, at 7.

22. 2008 N.Y. Laws ch. 388, 1088–91; Molinaro, *supra* note 21; Letter from Larry Levine, Assistant Deputy Superintendent & Chief Exam'r, Prop. Bureau, State of N.Y. Ins. Dep't, to All Authorized Prop./Cas. Insurers et al. (Nov. 18, 2008), available at [http://www.ins.state.ny.us/circltr/2008/clo8\\_26.htm](http://www.ins.state.ny.us/circltr/2008/clo8_26.htm).

23. See, e.g., Epstein & Keyes, *supra* note 13 ("For New York insurance law practitioners, New Year's 2009 will usher in substantial changes to long-standing fundamental principles of New York insurance law.").

24. See *id.*

25. See *id.*

## I. TREATMENT OF LATE NOTICE

## A. CONSEQUENCES OF LATE NOTICE

There are two primary rules that states use in the late-notice context.<sup>26</sup> The first approach, followed in a minority of states (including New York prior to 2009) is the “no-prejudice” rule.<sup>27</sup> In no-prejudice jurisdictions, timely notice is construed as a condition precedent to coverage.<sup>28</sup> As a result, for an insurer to avoid coverage, all that it must show is that notice was late.<sup>29</sup> There is no requirement of a showing that the insurer was prejudiced in any way by receiving the late notice.<sup>30</sup> Thus, the insurer need show no prejudice to disclaim coverage.

While notice provisions in no-prejudice states still have teeth, the majority of states no longer follow this rule and any impact it once had has been largely eviscerated.<sup>31</sup> Rather, most jurisdictions now apply some variation of the “notice-prejudice” rule, under which late notice does not relieve the insurer of its contractual duties “unless the insurer [has been] prejudiced as a result of the late notice.”<sup>32</sup> In fact, until January 2009, New York zealously adhered to the no-prejudice rule.<sup>33</sup> As recently as 2005, the highest court in New York expressly declined to reexamine the rule or change paths and adopt the notice-prejudice rule.<sup>34</sup>

The difference between the no-prejudice rule and the notice-prejudice rule are drastic. Moreover, changes in the law like that recently undertaken in New York have immediate and monumental effects on insureds and insurers alike. To illustrate, in the no-prejudice case of

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26. JERRY & RICHMOND, *supra* note 1, at 606–07. Insurance has traditionally been regulated solely by the states, thus each state has its own insurance law. See McCarran-Ferguson Act, 15 U.S.C. § 1011 (2006); *Monarch Life Ins. Co. v. Loyal Protective Life Ins. Co.*, 326 F.2d 841, 844 (2d Cir. 1963) (“In passing the McCarran Act, Congress was attempting to return primary responsibility for insurance regulation to the states; only when a state had not acted, would federal legislation become effective.”).

27. 13 RUSS & SEGALLA, *supra* note 4, § 193:32. After New York’s recent change in its law, only a handful of jurisdictions still adhere to the no-prejudice rule. See, e.g., *Nat’l R.R. Passenger Corp. v. Lexington Ins. Co.*, 445 F. Supp. 2d 37, 43–45 (D.D.C. 2006); *S.B. Corp. v. Hartford Accident & Indem. Co.*, 880 F. Supp. 751, 755–57 (D. Nev. 1995); *Haston v. Transamerica Ins. Servs.*, 662 So. 2d 1138, 1141 (Ala. 1995); *Caldwell v. State Farm Fire & Cas. Ins. Co.*, 385 S.E.2d 97, 99 (Ga. Ct. App. 1989); *Viani v. Aetna Ins. Co.*, 501 P.2d 706, 712–13 (Idaho 1972), *overruled in part on other grounds by Sloviaczek v. Estate of Puckett*, 565 P.2d 564, 568 (Idaho 1977); *Country Mut. Ins. Co. v. Livorsi Marine, Inc.*, 856 N.E.2d 338, 346–48 (Ill. 2006); *State Farm Fire & Cas. Co. v. Walton*, 423 S.E.2d 188, 192 (Va. 1992).

28. 13 RUSS & SEGALLA, *supra* note 4, § 193:32.

29. 22 HOLMES, *supra* note 2, § 139.1 (B); 13 RUSS & SEGALLA, *supra* note 4, § 193:32.

30. *Supra* note 29.

31. See *Brandon v. Nationwide Mut. Ins. Co.*, 769 N.E.2d 810, 813 n.3 (N.Y. 2002).

32. JERRY & RICHMOND, *supra* note 1, at 607.

33. See William Brennan, *N.Y. Requires Showing of Prejudice Before Insurers Disclaim for Late Notice*, *Ins. J.*, Aug. 6, 2008, <http://www.insurancejournal.com/news/east/2008/08/06/92396.htm>.

34. *Argo Corp. v. Greater N.Y. Mut. Ins. Co.*, 827 N.E.2d 762, 763–65 (N.Y. 2005).

*Reina v. United States Casualty Co.*, the plaintiff owned two cars.<sup>35</sup> The plaintiff insured his first car with United States Casualty Company and insured his second car with Hartford Accident Indemnity Company, a separate insurance provider.<sup>36</sup> When the policy on his second car lapsed, the plaintiff decided to insure both cars with United States Casualty.<sup>37</sup> The plaintiff's second car was then involved in an injury accident and the plaintiff inadvertently sent notice of the accident to Hartford, thinking that his second car was still insured with them and forgetting his decision to insure both cars with United States Casualty.<sup>38</sup> As a result of this mistake, United States Casualty, the actual insurer of the second car, did not receive notice of the accident until twenty-six days after it occurred.<sup>39</sup> The Supreme Court of New York, Appellate Division found the delay in notice inexcusable and ruled in favor of the insurer, United States Casualty, finding that there was no coverage because the insured had not provided notice within a reasonable amount of time.<sup>40</sup> Beyond this case, there are countless examples in New York case law applying the no-prejudice rule and finding similar delays in notice also unreasonable as a matter of law.<sup>41</sup>

Compared to the harsh realities of the New York no-prejudice rule in cases such as *Reina*, the notice-prejudice rule has far more equitable results. An illustrative notice-prejudice case is *Barnes v. Lumbermen's Mutual Casualty Co.*<sup>42</sup> In *Barnes*, the son of the insureds was killed in a car accident, and the insureds sought coverage under the uninsured motorist provision of their automobile insurance policy.<sup>43</sup> Notice of the accident and death was not provided to the insurer until over two-and-a-half years after the accident occurred.<sup>44</sup> The court held that despite the obvious delay in providing notice, the late notice had not prejudiced the insurer and thus the insurer was required to cover the claim.<sup>45</sup> As these two cases illustrate, whether a given jurisdiction follows the no-prejudice rule or the more lenient notice-prejudice rule can make a tremendous difference for both the insured and the insurer.

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35. 239 N.Y.S. 196, 197 (App. Div. 1930).

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 197-98.

41. See *New York v. Ludlow's Sanitary Landfill, Inc.* 50 F. Supp. 2d 135, 141 (N.D.N.Y. 1999) (citing numerous New York cases ruling that notice received within one to two months was late as a matter of law).

42. 308 So. 2d 326 (La. 1975).

43. *Id.* at 327.

44. *Id.*

45. *Id.* at 330.



## B. LATE NOTICE IN NEW YORK PRIOR TO 2007: WORKING TOWARDS A CHANGE

For decades, New York courts embraced the view that late notice to an insurer bars coverage.<sup>46</sup> This position was continually justified with a number of reasons, including that “the insurer [must have] an opportunity to protect itself”;<sup>47</sup> “that without timely notice, ‘an insurer may be deprived of the opportunity to investigate a claim and is rendered vulnerable to fraud’”;<sup>48</sup> “that late ‘notification may . . . prevent the insurer from providing a sufficient reserve fund’”;<sup>49</sup> that “prompt notice permits the . . . insurer to make an early estimate of potential exposure, to investigate the claim while witnesses and facts are available, and to take steps to prevent fraud”;<sup>50</sup> and that “early notice enables the insurer, *inter alia*, to exercise early control over the claim and enhances the possibility of settlement.”<sup>51</sup> Despite strong adherence to the no-prejudice rule for decades, and the many justifications for its use, beginning in the 1990s, the New York Court of Appeals began the process of its erosion by carving out a number of limited exceptions to the rule.<sup>52</sup>

In 1992, in *Unigard Security Insurance Co. v. North River Insurance Co.*, the court crafted an exception to the no-prejudice rule when dealing with contracts for reinsurance.<sup>53</sup> The court reasoned that the policy

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46. See, e.g., *Briggs Ave. LLC v. Ins. Corp. of Hannover*, 899 N.E.2d 947, 948–49 (N.Y. 2008); *Great Canal Realty Corp. v. Seneca Ins. Co.*, 833 N.E.2d 1196, 1197 (N.Y. 2005); *Sec. Mut. Ins. Co. of N.Y. v. Acker-Fitzsimons Corp.*, 293 N.E.2d 76, 78 (N.Y. 1972).

47. *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 594 N.E.2d 571, 573 (N.Y. 1992) (alteration in original) (quoting *Acker-Fitzsimons Corp.*, 293 N.E.2d at 78).

48. *Id.* (quoting *Power Auth. v. Westinghouse Elec. Corp.*, 505 N.Y.S.2d 420, 421 (App. Div. 1986)).

49. *Id.* (alteration in original).

50. *Id.* (citing *Sec. Mut. Cas. Co. v. Century Cas. Co.*, 531 F.2d 974, 978 (10th Cir. 1976)).

51. *Id.* (citing *Commercial Union Ins. Co. v. Int’l Flavors & Fragrances, Inc.*, 822 F.2d 267, 271 (2d Cir. 1987)).

52. See, e.g., *Rekemeyer v. State Farm Mut. Auto. Ins. Co.*, 828 N.E.2d 970, 974–75 (N.Y. 2005); *Brandon v. Nationwide Mut. Ins. Co.*, 769 N.E.2d 810, 814–15 (N.Y. 2002); *Unigard*, 594 N.E.2d at 573. Note that prior to these larger exceptions, New York law did recognize a small exception to the no-prejudice rule when the insured had a reasonable excuse for the delay in providing notice. See, e.g., *875 Forest Ave. Corp. v. Aetna Cas. & Sur. Co.*, 322 N.Y.S. 2d 53, 54–55 (App. Div. 1971) (good-faith belief of nonliability); *Rushing v. Commercial Cas. Ins. Co.*, 167 N.E. 450, 451 (N.Y. 1929) (lack of knowledge that an accident has occurred).

53. 594 N.E.2d at 575; see also *id.* at 574–75 (defining reinsurance, and clarifying the difference between reinsurance and primary insurance); *Employers Reinsurance Corp. v. Mid-Continent Cas. Co.*, 358 F.3d 757, 761 (10th Cir. 2004) (“Reinsurance is essentially insurance for insurance companies.”); *Excess & Cas. Reinsurance Ass’n v. Ins. Comm’r*, 656 F.2d 491, 492 (9th Cir. 1981) (“Reinsurance is a special form of insurance obtained by insurance companies to help spread the burden of indemnification. A reinsurance company typically contracts with an insurance company to cover a specified portion of the insurance company’s obligation to indemnify a policyholder in the event of a valid claim. This excess insurance, as it is called, enables the insurance companies to write more policies than their reserves would otherwise sustain since its [sic] guarantees the ability to pay a part of all claims. The reinsurance contract is not with the insured/policyholder. When a valid claim is

reasons for applying the no-prejudice rule in the primary insurance context were not present when dealing with reinsurance, so the no-prejudice rule should not apply.<sup>54</sup> The court noted the important differences between reinsurance and primary insurance contracts, namely, that reinsurance contracts are between sophisticated insurance companies.<sup>55</sup> There is no individual insured involved.<sup>56</sup> As a result, there is no duty to defend or to investigate.<sup>57</sup> In the reinsurance context, the interests of the primary insurer and the reinsurer are aligned, whereas in primary insurance, the interests of the insured and the insurer are often at odds.<sup>58</sup> As a result of these differences, the court held that the no-prejudice rule is inapplicable in the reinsurance context.<sup>59</sup>

In dictum, the *Unigard* court went on to observe that the no-prejudice rule is a limited exception to

two established rules of contract law: (1) that ordinarily one seeking to escape the obligation to perform under a contract must demonstrate a material breach or prejudice; and (2) that a contractual duty ordinarily will not be construed as a condition precedent absent clear language showing that the parties intended to make it a condition.<sup>60</sup>

Despite this strong language, and the court's willingness to make an exception for reinsurance, the court nonetheless did not otherwise relax the no-prejudice rule.<sup>61</sup>

A decade later, in *Brandon v. Nationwide Mutual Insurance Co.*, the court carved out another exception to the no-prejudice rule, this time in the context of supplemental uninsured motorist (SUM) coverage.<sup>62</sup> In *Brandon*, the court wrestled with the issue of whether to apply the no-prejudice rule in the SUM context when the notice of suit was late, but the original notice of a claim was timely.<sup>63</sup> Again, the court found that the justifications for the no-prejudice rule were not served by extending the rule to a late notice of suit when the notice of a claim was timely.<sup>64</sup> The court held that while a timely notice of suit "may indeed help SUM

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made, the insurance company pays the first level insured, and the reinsurance company pays the insurance company. The reinsurance company's obligation is to the insurance company, and the insurance company vis-a-vis the reinsurer is thus the insured, or more appropriately the 'reinsured.'" (citation omitted)); Aviva Abramovsky, *Reinsurance: The Silent Regulator?*, 15 CONN. INS. L.J. 345, 350-55 (2009).

54. 594 N.E.2d at 575.

55. *Id.* at 574.

56. *Id.*

57. *Id.*

58. *Id.* (noting that with primary insurance, there are sometimes "disputes over cooperation or coverage or over claimed collusion on the part of the insured").

59. *Id.* at 574-75.

60. *Id.* at 573 (citations omitted).

61. *See id.* at 575.

62. 765 N.E.2d 810, 814-15 (N.Y. 2002).

63. *Id.* at 811-13.

64. *Id.* at 813-14.

insurers to protect themselves against fraud, set reserves, and monitor and perhaps settle . . . tort actions,”<sup>65</sup> a timely notice of claim adequately serves these purposes and the insurer before the court had failed to establish that any prejudice from the late notice of suit was “so inevitable as to justify further extending the no-prejudice” rule.<sup>66</sup>

The SUM exception was further expanded in 2005 in *Rekemeyer v. State Farm Mutual Automobile Insurance Co.*<sup>67</sup> In *Rekemeyer*, notice to the insurer of the no-fault claim was timely, but a supplemental notice of intent to pursue a SUM claim was late.<sup>68</sup> The court followed *Brandon* and required the insurer to show that it was prejudiced by the late SUM claim in order to disclaim coverage.<sup>69</sup> Crucial to the decision was a finding that the initial notice of the no-fault claim “was sufficient to promote the valid policy objective of curbing fraud or collusion.”<sup>70</sup> Additionally, it was key that, after the notice of the no-fault claim, the insurer “undertook an investigation of the accident” and “required [the] plaintiff to undergo medical exams.”<sup>71</sup> The court concluded by stating that “[u]nder these circumstances, application of a rule that contravenes general contract principles is not justified.”<sup>72</sup>

In light of the court’s willingness to create some limited exceptions to the no-prejudice rule and to fully recognize that its application was contrary to basic contract principles, it would have seemed reasonable to expect the court to soon completely abandon the no-prejudice rule. However, any chance for such a change was crushed on the same day that *Rekemeyer* was decided.<sup>73</sup> In the companion case *Argo Corp. v. Greater New York Mutual Insurance Co.*,<sup>74</sup> the New York Court of Appeals expressly reaffirmed the use of the no-prejudice rule in late-notice cases and declined to adopt the notice-prejudice rule:

The rationale of the no-prejudice rule is clearly applicable to a late notice of lawsuit under a liability insurance policy. A liability insurer, which has a duty to indemnify and often also to defend, requires timely notice of lawsuit in order to be able to take an active, early role in the litigation process and in any settlement discussions and to set adequate reserves. Late notice of lawsuit in the liability insurance context is so

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65. *Id.* at 813.

66. *Id.* at 814.

67. 828 N.E.2d 970, 975 (N.Y. 2005).

68. *Id.* at 974–75.

69. *Id.* at 975.

70. *Id.* at 974.

71. *Id.*

72. *Id.*

73. See Norman H. Dachs & Jonathan A. Dachs, *Legislative Initiatives Regarding the ‘No-Prejudice Rule’*, N.Y.L.J., Sept. 11, 2007, at 3 (“[I]t appears that the courts have gone as far as they will go, and have stopped short of completely eviscerating the ‘no-prejudice’ rule.”).

74. 827 N.E.2d 762 (N.Y. 2005).

likely to be prejudicial to these concerns as to justify the application of the no-prejudice rule.<sup>75</sup>

In 2008, the high court again reaffirmed its decision to keep the no-prejudice rule.<sup>76</sup> It did so even while acknowledging that by that point, the legislature had already taken action to abandon the no-prejudice rule.<sup>77</sup>

As the years went by and New York courts in large part continued to strictly apply the no-prejudice rule, it had become increasingly clear that the rule was a minority position followed only in a small number of states.<sup>78</sup> As a result of this, and the inequitable outcomes that often accompanied a strict no-prejudice rule application, the rule began to draw the ire of both courts and commentators.<sup>79</sup> The no-prejudice rule was often dubbed "draconian" or otherwise criticized for its harshness.<sup>80</sup>

In dramatic fashion, even the Appellate Division of the New York Supreme Court stepped out of line and criticized the no-prejudice rule when it attempted to abandon the rule in the 2005 case of *Great Canal Realty Corp. v. Seneca Insurance Co.*<sup>81</sup> In *Great Canal*, a subcontractor was hurt while performing work on a jobsite.<sup>82</sup> The owner of the property, Great Canal Realty, was informed of the accident several weeks after it occurred but was told by the general contractor that the general contractor's insurance company would handle it because Great Canal was included on the policy as an additional insured.<sup>83</sup> Four months after the accident, the injured subcontractor served Great Canal with a lawsuit.<sup>84</sup> Within days of receiving notice of the suit, Great Canal forwarded the suit papers to its own liability insurer.<sup>85</sup> Predictably, the insurer disclaimed coverage on the grounds that notice was late.<sup>86</sup>

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75. *Id.* at 765.

76. *See Briggs Ave. LLC v. Ins. Corp. of Hannover*, 899 N.E.2d 947, 948 (N.Y. 2008).

77. *Id.* at 949 ("The Legislature, weighing the competing interests at stake, has recently enacted legislation that strikes a different balance, more favorable to the insured, but that legislation has not yet become effective. The common-law no-prejudice rule applies to this case." (citation omitted)).

78. *See, e.g., Great Canal Realty Corp. v. Seneca Ins. Co.*, 787 N.Y.S.2d 22, 25 (App. Div. 2004), *rev'd*, 833 N.E.2d 1196, 1197 (N.Y. 2005); *see also Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 228 (Colo. 2001); *Alcazar v. Hayes*, 982 S.W.2d 845, 850-51 (Tenn. 1998); *JERRY & RICHMOND*, *supra* note 1, at 606.

79. *See, e.g., Clementi*, 16 P.3d at 228-30; *Alcazar*, 982 S.W.2d at 850-51; *PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630, 634-36 (Tex. 2008); *Bennett & Zimmerman*, *supra* note 18; *Ann V. Kramer & Dennis J. Artese, New York Policyholders Look to Legislature for Relief in Late Notice Cases*, POLICYHOLDER ADVISOR, May-June 2005, at 1, available at <http://www.andersonkill.com/publications/pa/pdf/200505-06.pdf>.

80. *See supra* note 79.

81. 787 N.Y.S.2d at 29.

82. *Id.* at 22-23.

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

On appeal, the Appellate Division adopted the notice-prejudice rule and held that “a triable issue of fact exist[ed]” as to whether the insurer had been prejudiced by the late notice.<sup>87</sup> In reversing years of precedent, the court stressed the adhesive nature of insurance contracts and the windfall that insurers receive from denying late notice claims simply “because [they] could.”<sup>88</sup> The court noted that “the time has come . . . to look at ‘the end which ought to be attained’ and acknowledge that freedom of contract is a fiction when applied to insurance policies.”<sup>89</sup> In attacking the no-prejudice rule, the court reasoned that under the current rule “the insurer has been granted, wholly through judicial largess, the benefit of a conclusive presumption of prejudice.”<sup>90</sup> Ultimately, the court held that it could “see no reason to extend the ‘no-prejudice’ exception to allow insurers to disclaim coverage on the basis of late notice of claim where ‘lateness’ is an arbitrary temporal standard applied to a lapse between occurrence and notice, and where contractual rights favor just one party, the insurer.”<sup>91</sup>

As one might expect, the New York Court of Appeals did not agree with the lower court and quickly reversed the Appellate Division’s decision in a succinct three-paragraph opinion that did not address any of the policies central to the lower court opinion.<sup>92</sup> If a substantive change in New York’s application of the no-prejudice rule was going to come, it would have to come from the legislature, because the high court had shown that it was not yet ready to abandon the rule.

### C. ROUND 1: THE FIRST ATTEMPT AND THE SPITZER VETO

Legislative attempts to change the no-prejudice rule in New York date back several years, but it was not until 2007 that the attempts made any serious impact.<sup>93</sup> On June 17, 2007, Senate Bill 6306 was introduced in the New York State Senate.<sup>94</sup> The stated purpose of the bill was, *inter alia*, to “prevent[] a property/casualty insurer from denying coverage on the basis of late notice of claim, unless such insurer can demonstrate that they were ‘materially’ prejudiced by such late notice.”<sup>95</sup> In addition to the late notice portion of the bill, there was also a portion that permitted an injured third party to request a declaratory judgment and file a direct

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87. *Id.* at 23.

88. *Id.* at 26.

89. *Id.* at 27.

90. *Id.* at 25.

91. *Id.* at 29.

92. *Great Canal Realty Corp. v. Seneca Ins. Co.*, 833 N.E.2d 1196, 1197 (N.Y. 2005).

93. *Kramer & Artese*, *supra* note 79, at 1, 3.

94. S. 6306, 2007–2008 Leg., 230th Sess. (N.Y. 2007).

95. New York State Senate Introducer’s Memorandum in Support (2007), in N.Y. GOVERNOR’S VETO JACKET No. 98, VETO OF S. 6306, at 17, 17 (2007) [hereinafter VETO JACKET No. 98], available at <http://image.iarchives.nysed.gov/images/images/95612.pdf>.

action against the insurer in order to determine whether insurance coverage was available.<sup>96</sup> In less than one week, the bill was passed by both the New York State Senate and State Assembly.<sup>97</sup> Interestingly, the New York State Legislature's last day before summer recess was June 21, 2007, the same day that the State Assembly passed the bill and only four days after the bill's introduction.<sup>98</sup> Shortly after the bill's eleventh hour passage in the legislature, the bill was presented to Governor Eliot Spitzer to sign into law.<sup>99</sup>

Letters immediately began pouring into the Governor's office calling for the Governor to veto the bill on numerous grounds.<sup>100</sup> Some defended the status quo and the existing New York no-prejudice rule, calling it "a workable standard"<sup>101</sup> and arguing that "existing New York law protects policyholders."<sup>102</sup> Others called attention to the seemingly hasty fashion in which the bill was passed at the end of the legislative session.<sup>103</sup> Numerous groups attacked the bill based on their belief that, if signed into law, the "bill will both raise the cost of doing business in New York, and damage the state's attractiveness as a location for new and expanding businesses."<sup>104</sup>

However, the most powerful attacks on the bill were the substantive attacks on the actual text and provisions of the bill. Critics attacked the

96. Memorandum from Eliot Spitzer, N.Y. State Governor, to the New York State Senate (Aug. 1, 2007), in VETO JACKET No. 98, *supra* note 95, at 5, 5-6. This Note focuses exclusively on the late-notice aspects of the bill.

97. The June 21st vote in the State Assembly was 132 votes in favor and sixteen opposed while the June 20th vote in the State Senate was fifty-six votes in favor and six opposed. *See* VETO JACKET No. 98, *supra* note 95, at 2-4.

98. *Id.*; New York State Legislative Session Calendar: January-June 2007, available at <http://assembly.state.ny.us/leg/2007sessioncalendar.pdf>. This fact would ultimately draw much attention and suspicion to the bill. *See, e.g.*, Letter from Eric R. Dinallo, Superintendent of Ins., State of N.Y. Ins. Dep't, to David Nocenti, Counsel to the Governor, Executive Chamber (July 23, 2007), in VETO JACKET No. 98, *supra* note 95, at 45, 46 ("[T]he Department takes special exception to the fact that this bill was passed at the eleventh hour of the legislative session . . ."); Letter from Zane Morganstein, President, Associated Mut. Ins. Coop., to Eliot Spitzer, N.Y. State Governor (July 17, 2007), in VETO JACKET No. 98, *supra* note 95, at 41, 41 (noting that the bill was "passed by the legislature in the closing days of [2007's] legislative session").

99. *See* VETO JACKET No. 98, *supra* note 95, at 1.

100. *See generally id.* The bill was attacked for its late-notice provision as well as its direct-action provision. *See generally id.*

101. Memorandum from N.Y. State Bar Ass'n, Torts, Ins. & Comp. Law Section, to Dep't of Governmental Relations (July 3, 2007), in VETO JACKET No. 98, *supra* note 95, at 23, 23.

102. Letter from the Bus. Council of N.Y. State, Inc., to Legis. Sec'y, Executive Chamber (July 13, 2007) [hereinafter Bus. Council Letter], in VETO JACKET No. 98, *supra* note 95, at 34, 35; *see also* Letter from Gary Henning, Assistant Vice President, Ne. Region, Am. Ins. Ass'n, to David Nocenti, Counsel to the Governor, Executive Chamber (July 13, 2007), in VETO JACKET No. 98, *supra* note 95, at 37, 38 ("Current 'late notice' case law protects the interests of the insured.").

103. *See supra* notes 97-98 and accompanying text.

104. Bus. Council Letter, *supra* note 102, at 34; *see also* Letter from Zane Morganstein to Eliot Spitzer, *supra* note 98, at 42.

bill substantively for a number of the provisions it contained.<sup>105</sup> As written, the bill applied to *all insurance contracts*, including liability policies and first-party property insurance policies, as well as claims-made policies.<sup>106</sup> Claims-made policies have notice requirements that require claims to be made within the policy period or within a specific time after a loss rather than the vague “as soon as practicable” standard in most liability policies.<sup>107</sup> In protesting the inclusion of claims-made policies, critics argued that to subject these policies to the notice-prejudice rule would vitiate their existing notice requirements.<sup>108</sup>

The bill also came under attack for its immediate effective date, which some said would make it “almost impossible for insurers to change their policies and procedures immediately in order to comply with [the] bill.”<sup>109</sup> Others raised the issue that the bill required an insurer to show “material prejudice,” which many argued was a very high standard for insurers to meet.<sup>110</sup> Furthermore, some opined that litigation would be required to determine the bounds of “material prejudice.”<sup>111</sup>

In the end, the criticism and calls for a veto were successful. On August 1, 2007, Governor Spitzer vetoed the bill.<sup>112</sup> In his Veto Memorandum, Governor Spitzer acknowledged that the late-notice portion of the bill was “an important reform” that would eliminate “extreme hardship” and “bring New York’s laws into alliance with the laws in a majority of other states.”<sup>113</sup> However, in reference to the direct-action portion of the bill, he noted that “there is serious dispute about the actual impact of these provisions.”<sup>114</sup> The Governor also pointed out that much of the “dispute seems to result from the manner in which the bill was passed.”<sup>115</sup> In stressing the late passage of the bill, he emphasized that not all of the interested parties had had adequate time to voice their

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105. See, e.g., Letter from Eric R. Dinallo to David Nocenti, *supra* note 98, at 45–51; Letter from Gary Henning to David Nocenti, *supra* note 102, at 37–40. Note that the bill also came under heavy attack for its inclusion of a direct-action provision entirely separate from the changes in the treatment of late notice. See, e.g., *id.* at 37.

106. See Letter from Eric R. Dinallo to David Nocenti, *supra* note 98, at 50.

107. See *id.*

108. See, e.g., *id.*

109. *Id.*; Letter from Gary Henning to David Nocenti, *supra* note 102, at 40.

110. See, e.g., Letter from Eric R. Dinallo to David Nocenti, *supra* note 98, at 49; Letter from Gary Henning to David Nocenti, *supra* note 102, at 39.

111. See, e.g., Letter from John A. DeFrancisco, N.Y. State Senator & Helen E. Weinstein, N.Y. State Assembly Member, to David Nocenti, Counsel to the Governor, Executive Chamber (July 27, 2007) [hereinafter DeFrancisco & Weinstein Letter], in VETO JACKET No. 98, *supra* note 95, at 7, 7 (“[T]here is almost always litigation concerning the meaning of such key words in a bill.”).

112. Memorandum from Eliot Spitzer to the New York State Senate, *supra* note 96.

113. *Id.* at 5.

114. *Id.*

115. *Id.*

concerns with the provisions of the bill and, as a result, the legislature was not fully informed when it passed the bill.<sup>116</sup>

Interestingly, despite the procedural problems stressed by the Governor, he seemed inclined to sign a simpler notice-prejudice bill absent the direct action provision, stating that "if this bill merely permitted late notices of claim where there is no prejudice to the insurer, I would sign it."<sup>117</sup> Reaffirming this view, the Governor closed his memorandum by reiterating the soundness of the goals of the bill and outlining a plan for his office to work with other interested parties "to investigate [the] issue further and to determine the impact of these provisions on injured parties, on insurance rates, and on court caseloads."<sup>118</sup> The *New York Law Journal* noted this fact and commented that "[t]he governor appears to invite resubmission of a similar bill, at least with respect to a notice-prejudice standard."<sup>119</sup>

#### D. ROUND 2: GOVERNOR PATERSON'S SUCCESS

Before Governor Spitzer could follow through on his goal of working with interested parties to draft a new notice-prejudice bill, he resigned from office and was replaced by Lieutenant Governor David Paterson.<sup>120</sup> Governor Paterson did not waste any time on the late-notice issue. He soon "prepar[ed] and propos[ed] his own legislative initiative for introduction to the Legislature,"<sup>121</sup> and introduced this proposed legislation, Governor's Program Bill #65, in both the State Senate and the State Assembly.<sup>122</sup> Soon after its introduction, the bill unanimously passed both houses without any amendments.<sup>123</sup> Unlike the year before, the insurance industry recognized that the prospects for a second veto were slim. "Since it [was] a governor's program bill, there [was] not much

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116. *Id.*

117. *Id.*

118. *Id.* at 6.

119. Barry T. Basis, *Insurers Dodge Bullet in New York*, N.Y.L.J., Aug. 20, 2007, at 2 (characterizing the legislation as "potentially devastating" for the insurance industry). For an interesting theory of what truly motivated the Governor to veto the bill, see David B. Hamm, *Why Veto Bill to Amend CPLR 3001, Add Ins. Law 3451?*, N.Y.L.J., Nov. 16, 2007, at 4 (arguing that the Governor's attack on the direct-action portion of the bill was misplaced, and that it was used as a "whipping boy" for the insurers' efforts to avoid elimination of the 'no prejudice' rule").

120. See, e.g., Norman H. Dachs & Jonathan A. Dachs, *Status of 'No Prejudice' and Direct Action Legislation*, N.Y.L.J., July 3, 2008, at 3, 8.

121. *Id.*; GOVERNOR'S PROGRAM BILL 2008 MEMORANDUM, PROGRAM BILL NO. 65 (2008) [hereinafter PROGRAM BILL NO. 65], available at <http://royamura.googlepages.com/GovernorsProgramBill65-08.pdf>.

122. Phil Gusman, *N.Y. Legislature Passes Late Notice Bill*, P & C NAT'L UNDERWRITER, June 25, 2008, [http://www.propertyandcasualtyinsurancenews.com/cms/nupc/Breaking\\_News/2008/06/25-LATENOTICE-pg](http://www.propertyandcasualtyinsurancenews.com/cms/nupc/Breaking_News/2008/06/25-LATENOTICE-pg). The bill was introduced in the State Senate as Senate Bill 8610 and in the State Assembly as Assembly Bill 11541. Joel Stashenko, *New Late-Notice Rule Shifts Burden to Insurer*, N.Y.L.J., July 29, 2008, at 1-2.

123. Dachs & Dachs, *supra* note 120, at 8.



of an expectation for [another] veto . . . .”<sup>124</sup> As predicted, on July 21, 2008, the Governor signed the bill into law as chapter 388 of the Laws of New York 2008.<sup>125</sup>

Predictably, reactions to the passage of chapter 388 were mixed. Those in favor of the law praised the “watershed event” bringing New York more in line with the rest of the states and celebrated the end of the no-prejudice rule, calling it “a trap door,” “a gotcha’ defense,” “out of whack,” and “archaic and unfair.”<sup>126</sup> Those opposed to the passage lamented the end of the no-prejudice rule, arguing that “the bill is [not] warranted or helpful” and insisting that the no-prejudice rule was important for finality and helped to keep premiums low for all insureds.<sup>127</sup> The one thing that all parties could agree on was that chapter 388 “significantly alter[ed] the landscape of New York’s insurance law.”<sup>128</sup>

## II. CHAPTER 388: THE GOOD, THE BAD, AND THE UGLY

### A. AN INTRODUCTION TO CHAPTER 388 OF THE LAWS OF NEW YORK 2008

Before analyzing the effects of the changes in New York’s law, and the benefits and problems accompanying them, it is useful to look at the actual provisions related to late notice contained in chapter 388. As stated in the Governor’s memorandum accompanying the bill, one of the purposes of chapter 388 is to “prohibit[] certain liability insurers from denying coverage for a claim based on the failure to provide timely notice, unless the insurer suffers prejudice as a result of the delayed notice.”<sup>129</sup> In furtherance of this goal, the law amended section 3420(a) of the New York Insurance Law to require that every “policy or contract insuring against *liability* for injury to person, . . . or against *liability* for injury to, or destruction of, property” contains a provision stating that “failure to give any notice required to be given by such policy within the time prescribed therein shall not invalidate any claim made by the insured . . . unless the failure to provide timely notice has prejudiced the insurer.”<sup>130</sup> In addition to the clear importance of unequivocally requiring

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124. Gusman, *supra* note 122 (quoting Peter Tetrault, state affairs manager for the northeast region of the National Association of Mutual Insurance Companies (NAMIC)).

125. See, e.g., Letter from Larry Levine to All Authorized Prop./Cas. Insurers et al., *supra* note 22, at 1.

126. See Stashenko, *supra* note 122, at 1–2; see also Seth B. Schafner & Robyn S. Crosson, *Laws on Late Notice of Insurance Claims Improved*, N.Y.L.J., Aug. 14, 2008, at 4, 7.

127. Gusman, *supra* note 122.

128. Brennan, *supra* note 33.

129. PROGRAM BILL NO. 65, *supra* note 121, at 1. Again, beyond the late-notice rule, an additional, major aspect of the legislation was the direct-action portion, however this Note solely addresses the late-notice provisions.

130. N.Y. INS. LAW § 3420(a)(4)–(5) (McKinney 2007 & Supp. 2009) (emphasis added); 2008 N.Y.

that the notice-prejudice rule be incorporated into all covered policies, it is extremely important to note the scope of the law.

As emphasized in the above-quoted language, the new law only applies to liability policies and does not apply to property insurance policies.<sup>131</sup> Additionally, there is a separate exception for claims-made policies contained in section 3420(a)(5).<sup>132</sup> The exception allows claims-made policies to exclude the notice-prejudice language in their policies and instead include language requiring claims to be made "during the policy period, any renewal thereof, or any extended reporting period."<sup>133</sup> Thus, the coverage of this law—excepting from the notice-prejudice rule both property insurance policies and claims-made policies—is much narrower than the bill that Governor Spitzer vetoed, which by its terms applied to "all insurance coverage in the state."<sup>134</sup>

Crucial to the implementation of a notice-prejudice scheme is defining prejudice and establishing the burden of proof associated with showing prejudice. In defining prejudice, section 3420(c) of the Insurance Law provides that "[t]he insurer's rights shall not be deemed prejudiced unless the failure to timely provide notice *materially impairs* the ability of the insurer to investigate or defend the claim."<sup>135</sup> Despite prior complaints concerning the use of materiality to define prejudice, the new law largely retains the same definition as the 2007 legislation ("materially

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Laws ch. 388, 1089; *see also* PROGRAM BILL No. 65, *supra* note 121, at 1.

131. N.Y. INS. LAW § 3420(a), (a)(5); 2008 N.Y. Laws ch. 388, 1089; No Prejudice Lives in the Property Insurance World, <http://nycoveragecounsel.blogspot.com/2008/06/no-prejudice-lives-in-property.html> (June 27, 2008, 12:19 pm); *see also* discussion *infra* Part II.C.1 (discussing the choice to exclude property insurance).

132. N.Y. INS. LAW § 3420(a)(5); 2008 N.Y. Laws ch. 388, 1089; Jeffrey P. Griffin, Note, *The Inapplicability of the Notice-Prejudice Rule to Pure Claims-Made Insurance Policies*, 42 CONN. L. REV. 235, 269 n.227 (2009).

133. *Supra* note 132. Most states that have addressed the issue similarly do not apply the notice-prejudice rule to claims-made policies. *See, e.g.*, Griffin, *supra* note 132, at 251–69; Pizzini v. Am. Int'l Specialty Lines Ins. Co., 210 F. Supp. 2d 658, 669–70 (E.D. Pa. 2002) (applying Pennsylvania law, and refusing to extend the notice-prejudice rule to claims-made policies, grounding its decision on both those of other courts and in the different purpose that notice provides in a claims-made policy); City of Harrisburg v. Int'l Surplus Lines Ins. Co, 596 F. Supp. 954, 962 (M.D. Pa. 1984) ("[T]he purpose of the notice provision in an occurrence policy [is] to give the insurer time to investigate the claim for defense or settlement . . . . In a claims-made policy, the provision requiring notice before the end of the policy period serves a different purpose. It provides a certain date after which an insurer knows that it no longer is liable under the policy, and accordingly, allows the insurer to more accurately fix its reserves for future liabilities and compute premiums with greater certainty."); *see also* Anthony Bartell & Craig W. Davis, *McCarter and English LLP on Notice and Reporting Requirements in Claims-Made-and-Reported Policies: A Potential Trap for Both Courts and Policyholders*, 2009 Emerging Issues 4190 (LexisNexis), at 1–3.

134. *See* S. 6306, 2007–2008 Leg., 230th Sess. (N.Y. 2007); *supra* note 106 and accompanying text. This fact will be discussed further *infra* Part II.C.1.

135. N.Y. INS. LAW § 3420(C) (emphasis added).

impairs” in the 2008 version versus “material prejudice” in the 2007 version).<sup>136</sup>

Under the new law, the date when notice is actually provided to the insurer determines which party bears the burden of showing the presence or absence of prejudice.<sup>137</sup> If notice is provided within “two years of the time required under the policy,” the burden of showing prejudice is on the insurer.<sup>138</sup> On the other hand, if “notice was provided more than two years after the time required under the policy,” the insured has the burden of showing “that the insurer has not been prejudiced.”<sup>139</sup> In instances where prior to the insurer receiving notice, “the insured’s liability has been determined by a court of competent jurisdiction, . . . by binding arbitration,” or by a settlement of the suit by the insured, the law establishes an irrebuttable presumption of prejudice.<sup>140</sup>

The final, important aspect of the notice-prejudice provisions of chapter 388 is contained in section 8, which provides that “[t]his act shall take effect on the one hundred eightieth day after it shall have become law and shall apply to policies issued or delivered in this state on or after such date and to any action maintained under such policy.”<sup>141</sup> Thus by its terms, the new law is not retroactive in its effect and, accordingly, its effect runs only to policies issued or reissued on or after January 17, 2009 (180 days after the bill’s passage on July 21, 2008).<sup>142</sup> Here, again, the new law departs from the vetoed version, which would have taken effect immediately had it passed.<sup>143</sup>

## B. A WELCOME CHANGE AND A HARBINGER OF THINGS TO COME

First and foremost, the state of New York should be applauded for the important step that it took to abolish the no-prejudice rule. The New York Legislature’s decision continued the modest liberalization of the rule brought on in *Unigard*,<sup>144</sup> *Brandon*,<sup>145</sup> and *Rekemeyer*,<sup>146</sup> but went further than the high court of New York had been willing to go.<sup>147</sup> More importantly, this change is likely to have long-term repercussions across

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136. See *id.*; *supra* notes 110–11 and accompanying text.

137. N.Y. INS. LAW § 3420(c)(2)(A).

138. *Id.*

139. *Id.*

140. See *id.* § 3420(c)(2)(B).

141. 2008 N.Y. Laws ch. 388, 1091.

142. See *id.*; Letter from Larry Levine to All Authorized Prop./Cas. Insurers et al., *supra* note 22, at

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143. See *supra* note 109 and accompanying text.

144. 594 N.E.2d 571, 573 (N.Y. 1992).

145. 769 N.E.2d 810, 815 (N.Y. 2002).

146. 828 N.E.2d 970, 975 (N.Y. 2005).

147. See, e.g., *Argo Corp. v. Greater N.Y. Mut. Ins. Co.*, 827 N.E.2d 762, 765 (N.Y. 2005).

the nation, and is likely to be a bellwether of further abandonment of the no-prejudice rule in other states.<sup>148</sup>

For far too long New York rigidly applied a rule that was anything but fair. To put the no-prejudice rule in the proper context, compare, for example, its harsh effects to those of other activities: "A homeowner can be late in making a mortgage payment but still keep his home. At common law, even a dog got one bite. There is no free bite, however, no opportunity to 'kiss and make up,' for the insurance policyholder."<sup>149</sup> For many states, the only option to avoid this irrational outcome was to adopt the notice-prejudice rule.

In abandoning the no-prejudice rule, state high courts usually cite a public-policy concern that justifies the more equitable results of the notice-prejudice rule.<sup>150</sup> There are three common rationales frequently cited by courts: "1) the adhesive nature of insurance contracts; 2) the public policy objective of compensating tort victims; and 3) the inequity of the insurer receiving a windfall due to a technicality."<sup>151</sup> Each of these rationales is persuasive on its own but, taken together, they are illustrative of why so many states have adopted the notice-prejudice rule.<sup>152</sup>

In fact, in *Great Canal Realty Corp. v. Seneca Insurance Co.*, the New York Supreme Court, Appellate Division relied heavily on two of these rationales in attempting to abandon the no-prejudice rule.<sup>153</sup> In adopting the notice-prejudice rule, the court emphasized both the adhesive nature of insurance contracts as well as the windfall that insurers receive from disclaiming coverage after having received premiums to pay for the coverage now being denied to the insured.<sup>154</sup>

Surprising as it may seem, even some in the insurance industry have long acknowledged the unjust outcome required by strict adherence to the no-prejudice rule and advocated for a more equitable result. According to Anderson, Tuttle, and Crego, by the late 1990s,

[a]t least one insurance company ha[d already] recognized the unfairness of forfeiture. The Aetna Technical Claim Manual affords its low-level claims handlers great discretion in waiving alleged late notice, advising that "[i]f there is six months to a year delay, use your discretion relative to acceptance if there is no prejudice."<sup>155</sup>

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148. See *supra* notes 14–18 and accompanying text.

149. Anderson et al., *supra* note 8, at 826–27.

150. See, e.g., *Alcazar v. Hayes*, 982 S.W.2d 845, 850 (Tenn. 1998).

151. *Id.*

152. See generally Charles C. Marvel, Annotation, *Modern Status of Rules Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insured's Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers*, 32 A.L.R. 4TH 141 (1984).

153. 787 N.Y.S.2d 22, 24–30 (App. Div. 2004), *rev'd*, 833 N.E.2d 1196, 1197 (N.Y. 2005).

154. *Id.*

155. Anderson et al., *supra* note 8, at 841 (third alteration in original) (quoting AETNA TECHNICAL

Though this policy manual is thirty years old, it illustrates that those inside the industry have recognized that reasonableness and leniency are better policies than strictness and irrationality. Insureds are clients, after all, and it is in the best interest of an insurer to keep its clients happy and treat them fairly.

With the clear majority of states accepting the inherent fairness and justness of the notice-prejudice rule, New York's movement into the majority is a clear step in the right direction and one that should have dramatic implications outside of the state. This might be unlikely to occur with other states but, as New York State is uniquely entwined with the insurance industry, changes in its insurance law reach far and wide.<sup>156</sup>

With such a large impact on the insurance industry, New York's recent action likely signals the end of the no-prejudice rule in the United States. If a state with a massive insurance industry such as New York adopts the notice-prejudice rule, how can states such as Nevada, Alabama, and Idaho continue to adhere to the archaic and draconian no-prejudice rule?<sup>157</sup> Moreover, when state high courts take on the issue of how best to deal with late notice in the insurance context, they generally survey the rules followed in other states.<sup>158</sup> If New York is suddenly absent from the no-prejudice side of the equation, and only a handful of small states are left, it may be impossible for those remaining states to not follow suit and leave the no-prejudice rule to the history books. Furthermore, of the handful of states applying a no-prejudice rule, very few of their highest courts have actually considered the rule in recent years.<sup>159</sup> When they next have the opportunity to do so, it seems likely that they will have a difficult time ignoring the significant progress that New York has made and will therefore likely follow New York's lead and abandon the no-prejudice rule.

As a result, it is quite possible that New York State's adoption of the notice-prejudice rule in chapter 388 will come to be seen as the *coup de grâce* for the no-prejudice rule. Fewer and fewer states continue to follow the no-prejudice rule and, with New York abandoning it, it seems likely that it will soon become a relic of the past. More than anything else, this is the most important result of this law—its greatest impact might be on the insurance jurisprudence *outside* of New York rather than within the state.

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CLAIM MANUAL B-5-1 (1977)).

156. See *supra* notes 14–18 and accompanying text.

157. See *supra* note 27 and accompanying text (discussing jurisdictions that still apply the no-prejudice rule).

158. See, e.g., *Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 230 (Colo. 2001); *Prince George's County v. Local Gov't Ins. Trust*, 879 A.2d 81, 95–96 (Md. 2005); *Alcazar v. Hayes*, 982 S.W.2d 845, 849–56 (Tenn. 1998).

159. See *Alcazar*, 982 S.W.2d at 853.

### C. THE PROBLEMS OF CHAPTER 388

This section discusses some of the questionable and contentious provisions in chapter 388. The following subsections will examine how the law (1) applies to liability policies only, (2) allocates the burden to show prejudice, (3) defines prejudice, and (4) applies retroactively. It will also provide suggestions as to how courts should interpret these provisions.

#### 1. *Liability Policies Only*

The first potential problem with the new law is that it only applies to liability policies and still subjects property policies to the inequitable results of the no-prejudice rule.<sup>160</sup>

From the limited legislative record, it is unclear whether excluding property policies from the new law was intentional or a drafting oversight.<sup>161</sup> If it was actually intended, it is unclear if the decision to exclude property policies from coverage received much, if any, consideration or debate.<sup>162</sup> On its face, the limitation to liability policies could have been intended based on the bill's stated purpose to "prohibit[] certain liability insurers" from disclaiming coverage.<sup>163</sup> However, as a result of the likely effects of excluding property policies from the coverage of chapter 388, it is at least up for debate whether or not this limitation received serious thought or debate.

To be sure, there are numerous differences between first-party property policies and third-party liability policies, which—at least in certain contexts—have justified different treatment of these policies.<sup>164</sup> In the third-party context, the insured is subject to potential liability to a third party and the insurer has a fiduciary duty to the insured.<sup>165</sup> By contrast, in the first-party context, there is no fiduciary duty to the insured and no potential liability for the insured.<sup>166</sup> However, these

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160. See N.Y. INS. LAW § 3420(a) (McKinney 2007 & Supp. 2009).

161. The bill passed exactly as submitted by the governor's office without amendment by the state legislature. See Molinaro, *supra* note 21, at 8. Furthermore, it did not go before the insurance committee in either house of the legislature. See *id.*

162. See *id.*

163. See PROGRAM BILL No. 65, *supra* note 121, at 1.

164. See *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 799–800 (Utah 1985); Dominick C. Capozzola, Note, *First-Party Bad Faith: The Search for a Uniform Standard of Culpability*, 52 HASTINGS L.J. 181, 184–85 (2000). *Beck* offers further clarification of the differences between first-party claims and third-party claims. See 701 P.2d at 798 n.2 ("We use the term 'first-party' to refer to an insurance agreement where the insurer agrees to pay claims submitted to it by the insured for losses suffered by the insured. . . . In contrast, a 'third-party' situation is one where the insurer contracts to defend the insured against claims made by third parties against the insured and to pay any resulting liability, up to the specified dollar limit.").

165. See, e.g., *Beck*, 701 P.2d at 798 n.2.

166. See *id.*

differences are much more relevant to discussions of extending the tort of bad faith to first-party claims than to treatment of late notice.

In claims for bad faith, the focus is on the conduct of the insurer—specifically, whether the insurer breached the duty of good faith and fair dealing that is read into every insurance contract.<sup>167</sup> As a result, whether or not there is a fiduciary duty is quite relevant in evaluating the conduct of the insurer and in deciding whether or not bad faith should be extended to the first-party context.<sup>168</sup> However, when dealing with late notice, the focus is on the conduct of the insured—specifically, whether the insured provided notice in a timely manner. As the focus is entirely on the conduct of the insured, the presence or absence of a fiduciary duty of the insurer seems irrelevant; it makes sense to treat first-party and third-party late notice cases similarly.

As discussed previously, courts usually rest their decision to move to a notice-prejudice standard on one of three public policy bases.<sup>169</sup> To reiterate, these bases are “1) the adhesive nature of insurance contracts; 2) the public policy objective of compensating tort victims; and 3) the inequity of the insurer receiving a windfall due to a technicality.”<sup>170</sup> In the first-party property context, the insurance contracts are no less adhesive than in the third-party context.<sup>171</sup> The insured is often forced to accept the insurer’s terms and has no control over the policy language.<sup>172</sup> Furthermore, the windfall that the insurer receives by disclaiming coverage is just as inequitable in first-party cases as in third-party cases.<sup>173</sup> In both situations, the insurer is able to keep premiums paid to it for coverage that it has not provided.

It is true that, in first-party property cases, there is no tort victim to compensate and no third-party liability about which to worry. However,

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167. Capozzola, *supra* note 164, at 184.

168. See *Lawton v. Great S.W. Fire Ins. Co.*, 392 A.2d 576, 580–81 (N.H. 1978).

169. See *Alcazar v. Hayes*, 982 S.W.2d 845, 850 (Tenn. 1998).

170. *Id.*

171. See, e.g., *Aetna Cas. & Sur. Co. v. Murphy*, 538 A.2d 219, 222 (Conn. 1988) (“Standardized contracts of insurance continue to be prime examples of contracts of adhesion, whose most salient feature is that they are not subject to the normal bargaining processes of ordinary contracts.”); JEFFERY W. STEMPER, *STEMPEL ON INSURANCE CONTRACTS* § 4.08(A) (3d ed. 2005) (characterizing all insurance contracts as not merely adhesive in their nature but “super-adhesive”).

172. See, e.g., *Aetna Cas. & Sur. Co.*, 538 A.2d at 222.

173. See, e.g., *Motorists Mut. Ins. Co. v. Post*, No. 204–487, 2005 U.S. Dist. LEXIS 24415, at \*4 (E.D. Ky. Oct. 20, 2005) (applying Kentucky law, and applying the notice-prejudice rule to a first-party case, specifically noting that allowing the insurer “to deny coverage absent a showing of prejudice provides it with a windfall, as [the insured] would have reaped the benefit of the insurance premiums without any liability for subsequent loss”); *Yannitsadis v. Mission Nat’l Ins. Co.*, No. 84-4025, 1986 U.S. Dist. LEXIS 29572, at \*4 (D.N.J. Feb. 6, 1986) (applying New Jersey law, and applying the notice-prejudice rule to a first-party case, explicitly rejecting the argument that the notice-prejudice rule should not be applied in the first-party context and stating that “automatic forfeiture of coverage due to a technical breach in an adhesion policy is inconsistent with any notion of fairness. This is no less true when the policy involved provides coverage for fire loss rather than liability.”).

as mentioned, the insurance contracts in question are still adhesive and an insurer still receives a windfall when it disclaims coverage for nonprejudicial late notice.<sup>174</sup> Thus, two of the three policy reasons for applying the notice-prejudice rule are clearly present in first-party cases.<sup>175</sup> It would seem, then, that public policy dictates that the notice-prejudice rule should extend to both liability policies and property policies. Many courts have implicitly held as much in choosing to apply the notice-prejudice rule in the first-party property insurance context.<sup>176</sup> Such an extension to non-claims-made, property-insurance policies is logical. The exclusion of property insurance from chapter 388 is therefore unwarranted. The law should be extended to cover property insurance.

As a result of the current New York framework that excludes property policies from the notice-prejudice requirement, courts will be faced with some difficult decisions in a number of areas.

For example, how should New York courts treat a "hybrid policy"?<sup>177</sup> For example, most automobile insurance policies insure against liability and property damage (collision) in a single policy.<sup>178</sup> This is also true in most homeowners' insurance policies.<sup>179</sup> Must an insurer include the notice-prejudice language required by chapter 388 in such a hybrid policy? Must it only be included in the liability portion of the policy but not the property portion? These are tricky issues with which courts will have to wrestle. Furthermore, these hybrid policies have traditionally been textbook examples of adhesion contracts, with the insured having little ability to influence the terms of the contract.<sup>180</sup>

174. See, e.g., *supra* note 173.

175. See *supra* notes 171–73 and accompanying text.

176. See, e.g., *Generali—U.S. Branch v. Genesis Ins. Co.*, 925 F. Supp. 224, 227–28 (S.D.N.Y. 1996) (applying Pennsylvania law); *Colonial Gas Energy Sys. v. Unigard Mut. Ins. Co.*, 441 F. Supp. 765, 768–71 (N.D. Cal. 1977) (applying California law); *Hood v. Fireman's Fund Ins. Co.*, 412 F. Supp. 846, 851–57 (S.D. Miss. 1976) (applying Mississippi law); *PirkI v. Nw. Mut. Ins. Ass'n*, 348 N.W.2d 633, 633–36 (Iowa 1984); *Nat'l Liberty Ins. Co. v. Herring Nat'l Bank*, 135 S.W.2d 219, 224 (Tex. Civ. App. 1939). Compare, e.g., *Caddell v. Travelers Lloyds of Tex. Ins. Co.*, No. 06-06-00063, 2007 WL 1574244, at \*3 (Tex. App. June 1, 2007) (applying the no-prejudice rule to a first-party action in a jurisdiction that follows the notice-prejudice rule in third-party cases, and noting that "the apparent injustice recognized by the Texas Supreme Court in 1972 in the *Cutaia* case remains the law as to [property insurance]"), and *Flores v. Allstate Tex. Lloyd's Co.*, 278 F. Supp. 2d 810, 816 (S.D. Tex. 2003) ("However, the Texas Insurance Board Orders requiring a showing of prejudice . . . are restricted to automobile and general liability insurance policies."), with *Ridglea Estate Condo. Ass'n v. Lexington Ins. Co.*, No. 04-10447, 2005 U.S. App. LEXIS 16724, at \*16–17 (5th Cir. Aug. 10, 2005) (requiring prejudice to be shown before the insurer could disclaim coverage under a property insurance policy).

177. I use the term "hybrid policy" to refer to policies that insure against both liability claims and property claims.

178. See 1 MILLER & LEFEBVRE, *supra* note 3, at 1–11.

179. See *id.* at 201–20.

180. See, e.g., *Sprately v. Aetna Cas. & Sur. Co.*, 704 F. Supp. 595, 599 (E.D. Pa. 1989) ("The insurance policy in question here is an adhesion contract, in that, like other automobile insurance contracts, it is not the result of arm's length negotiations as to its language."); *Farmers Ins. Exch. v.*



To illustrate the problems with hybrid policies, imagine a situation where a car is struck in a rear-end accident (Collision 1). After being struck, the momentum of the first collision carries the car forward, causing it to smash into a third car that was stopped in front of it and injuring the driver of the third car (Collision 2). The driver of the car involved in both collisions has an automobile policy that provides coverage for property damage and liability. The property-damage portion of the policy will be called upon for the damage caused to the car from Collision 1. At the same time, the liability portion of the policy will be called upon to address the subsequent accident and the injury to the driver of the third car in Collision 2. Now, assume that notice to the insurer is late.<sup>181</sup>

Must the insurer show prejudice to deny the liability claim from Collision 2 but not to deny the property claim from Collision 1? If the answer is yes, one must ask if that is the result that the New York Legislature intended. Even if the legislature explicitly limited the legislation solely to liability insurance (as it seems to have done), logic would seem to dictate that such a result is a windfall for an insurer that has received premiums for its coverage, and now is free from providing coverage to the insured.<sup>182</sup>

Additionally, it is highly unlikely that an average policyholder will appreciate the important differences between first-party and third-party claims and the potential adverse results that late notice would create in one context and not the other. This is particularly true in hybrid policies where the policyholder is unlikely to even realize that there are two types of coverage within a single policy. In some jurisdictions, a court might be willing to intervene in a situation where a hybrid policy is at issue. Through the well-established interpretation methods of reasonable expectations and *contra proferentum*, a court could interpret the policy to incorporate the notice-prejudice rule for all coverage.<sup>183</sup> But in New York, where *contra proferentum* is used sparingly, this seems unlikely to occur.<sup>184</sup>

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Call, 712 P.2d 231, 236 (Utah 1985) (“[A]utomobile insurance is generally sold through adhesion contracts that are not negotiated at arm’s length.”).

181. I credit Dean Leo Martinez, University of California Hastings College of the Law, with suggesting this hypothetical.

182. See *Motorists Mut. Ins. Co. v. Post*, No. 204-487, 2005 U.S. Dist. LEXIS 24415, at \*4 (E.D. Ky. Oct. 20, 2005); *Yannitsadis v. Mission Nat’l Ins. Co.*, 1986 U.S. Dist. LEXIS 29572, at \*4 (D.N.J. Feb. 6, 1986).

183. See, e.g., *E.M.M.I. Inc. v. Zurich Am. Ins. Co.*, 84 P.3d 385, 389–90 (Cal. 2004) (discussing interpretation of insurance contracts).

184. Howard B. Epstein & Theodore A. Keys, *Contra Proferentum: Sophisticated Entities Negotiating*, N.Y.L.J., Aug. 30, 2006, at 3, available at <http://www.srz.com/news/list.aspx?Professionals=cd58e436-3f80-4c93-af7d-6fd9fcb5758>.

If the exclusion of property policies from coverage under chapter 388 was intentional, it was certainly not well thought out. If unintentional, this probably occurred as a result of legislative efforts to exclude claims-made policies from coverage and in response to criticisms of the 2007 legislation, which as written would have affected all insurance contracts.<sup>185</sup> If the legislature does not immediately revise the law, New York courts will have ample opportunity to decide how best to handle late notice in property insurance policies and hybrid policies. Should the courts decide to strictly follow the law as set forth in section 3420 (not an unlikely scenario), we will be—to some extent—back at square-one, with the no-prejudice rule still alive in some contexts; it will then fall back on the legislature to remedy the problem.

## 2. *Allocation of the Burden to Show Prejudice*

Another area of chapter 388 that requires further analysis is the allocation of the burden to show prejudice (or a lack thereof). Under the new law, the burden to show prejudice after late notice rests with the insurer if notice is received during the first two years after notice would have been reasonable.<sup>186</sup> If notice is more than two years late, the burden shifts to the insured to show that the insurer has not been prejudiced.<sup>187</sup>

To begin, the actual point at which the burden shifts (two years after notice was due) seems arbitrary.<sup>188</sup> Why not one year?<sup>189</sup> Why not three years? Perhaps this was a happy medium agreed upon by individuals in the Governor's office to provide a nice balance between claims that were presumptively not prejudicial (those where notice came within two years, so the burden rests with the insurer to show prejudice) and claims that were presumptively prejudicial (those where notice came more than two years late, so the burden rests with the insured to show the insurer was not prejudiced). If this was in fact the case, why was the point at which the burden shifts set at two years? Were studies conducted that indicated that two years is the point at which time mere late notice generally becomes prejudicial late notice? Obviously, this is doubtful but it would be interesting to see or hear the justification for the decision to shift the burdens at two years. As will be shown, the entire burden-shifting regime is complicated and will likely lead to needless litigation.

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185. See generally sources cited *supra* notes 94–95 and accompanying text.

186. N.Y. INS. LAW § 3420(c)(2)(A) (McKinney 2007 & Supp. 2009).

187. *Id.*

188. The legislative record does not indicate why the determination that “two years” after notice would have been reasonable was chosen as the proper point for showing prejudice. See generally PROGRAM BILL NO. 65, *supra* note 121.

189. Wisconsin, one of the few states that has statutes governing late notice, uses a period of one year after notice was due to determine whether or not there will be a presumption of prejudice. See WIS. STAT. ANN. § 631.81 (West 2004 & Supp. 2007); *Neff v. Pierzina*, 629 N.W.2d 177, 183–85 (Wis. 2001).

Beyond the arbitrary two-year period, there is likely to be significant litigation in determining the precise date that the allocation of the burden shifts. Because the burden does not shift two years after a loss, occurrence, notice of suit, etc., but rather shifts two years “after the time required under the policy,” the determination of when notice was required under the policy will be hotly contested—particularly in instances where a few days difference would change which party bears the burden.<sup>190</sup>

As previously mentioned, despite different language contained in policies requiring notice (i.e., “immediately,” “as soon as practicable,” etc.), courts generally interpret notice to be due within a reasonable amount of time.<sup>191</sup> Therefore, to accurately determine which party bears the burden to prove prejudice, first a determination must be made as to when notice was actually required. Once that date is determined, one must add two years to it and compare that date to the date when notice was given. This is a substantially different process from a traditional ruling in a no-prejudice case as to whether notice was timely or not because, in those cases, the only determination made was whether or not notice was late (i.e., received in a reasonable amount of time); no determination of an actual date on which notice would have been acceptable has to be made.<sup>192</sup>

The key issue then is determining when the clock starts to run on the two-year period at the end of which the burden shifts. In situations where notice is provided slightly past two years after an accident or occurrence, the court will have to split hairs to determine the exact date when notice shifted from timely to late. In New York, there is a three-year statute of limitations on personal injury suits, so it is not unrealistic to imagine some plaintiffs not filing suit until more than two years after an accident.<sup>193</sup>

Imagine that notice is provided to the insurer two years and ten days after an accident. The court would have to determine the exact date when notice was due, or, at least, at what point notice became late. If notice was due within eleven days, then the insurer bears the burden of showing it was prejudiced because it received notice within two years “after the time required by the policy.” However, if notice was due within nine days, then the insured bears the burden of showing that the

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190. N.Y. INS. LAW § 3420(c)(2)(A).

191. See 22 HOLMES, *supra* note 2, §139.3; JERRY & RICHMOND, *supra* note 1, at 602; *see also, e.g.*, *Power Auth. v. Westinghouse Elec. Corp.*, 502 N.Y.S.2d 420, 422 (App. Div. 1986); 875 Forest Ave. Corp. v. Aetna Cas. & Sur. Co. 322 N.Y.S.2d 53, 55 (App. Div. 1971).

192. See, e.g., *Power Authority*, 502 N.Y.S.2d at 422-23 (applying no-prejudice rule and finding that notice was late but that notice would have been reasonable as early as a certain date and as late as one month after that date). Rulings like this create windows of when notice would have been timely, rather than a specific date.

193. See N.Y. C.P.L.R. 214 (McKinney 2003).

insurer has not been prejudiced because the insured provided notice more than two years after it was due. One can clearly see the huge importance placed on the finding of when notice is required by the policy since that bears heavily on allocating the burden between the parties. Granted, it will not always be unclear which party bears the burden but, any time that notice comes approximately two years after an accident or occurrence, it will be a highly contentious issue.

Further issues arise when notice comes more than two years after it was required under the policy and thus the insured has the burden to prove that the insurer was not prejudiced by the late notice.<sup>194</sup> Such a rule seems unjustified because presumably it will be quite easy (and therefore, not burdensome) for an insurer to show that it was prejudiced when it received notice more than two years late. After all, it is the insurer that generally possesses the evidence that would establish whether it was burdened.<sup>195</sup> One must ask if the insurer really needs the presumption of prejudice. If it is so easy for an insurer to show it was prejudiced, then why bother shifting the burden? On the other hand, if the insurer has not been prejudiced by receipt of notice more than two years after it was due, it seems illogical to place the burden of proof on the insured.

An additional problem is that the courts will be asking the insured to prove a negative—that the insurer has *not* been prejudiced. Courts have frowned upon such negative proof for years.<sup>196</sup> Furthermore, much of the evidence of whether an insurer was or was not prejudiced by the late notice is not available to the insured.<sup>197</sup> Even the New York Court of Appeals has noticed the problems in this situation. In *Brandon v. Nationwide Mututal Insurance Co.*, it placed “the burden of proving prejudice on the insurer because [the insurer] has the relevant

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194. N.Y. INS. LAW § 3420(c)(2)(A).

195. See, e.g., *Weaver Bros., Inc. v. Chappel*, 684 P.2d 123, 126 (Alaska 1984) (“Information regarding prejudice is generally more readily available to the insurer than the insured. The insurer is in a better position to demonstrate that its ability to investigate, defend or settle a claim has been impaired.”).

196. See, e.g., *Vieth v. Jubelirer*, 541 U.S. 267, 311 (2004) (Kennedy, J., concurring in judgment) (“[P]roving a negative is a challenge in any context.”); *Elkins v. United States*, 364 U.S. 206, 218 (1960) (“[A]s a practical matter it is never easy to prove a negative . . . .”); Charles V. Laughlin, *The Location of the Burden of Persuasion*, 18 U. PITT. L. REV. 3, 5–6 (1956); Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 HASTINGS L.J. 239, 249 & nn.34–35 (1985).

197. *Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 231 (Colo. 2001) (“‘[A]lthough it may be difficult for [an] insurance company to prove it suffered prejudice as a consequence of an untimely notice, it appears to us that it would be at least as difficult for [a] claimant to prove a lack of prejudice.’ . . . The *Brakeman* court chose to place the burden of showing prejudice on the insurance company because of the adhesive nature of an insurance contract, the severity of forfeiture and the fact that it was the insurance company who is choosing to disclaim its obligations under the policy.” (citation omitted) (quoting *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193, 198 (Pa. 1977))).

information about its own claims-handling procedures and because the alternative approach would saddle the policyholder with the task of proving a negative.”<sup>198</sup>

It is true that, in very few jurisdictions, late notice always results in a presumption of prejudice that is rebuttable by the insured.<sup>199</sup> Doctrinally, one could consider this a notice-prejudice located within a presumption-of-prejudice rule. This rule, though followed in some states, is an extreme minority position (similar to the no-prejudice rule) that has come under heavy scrutiny.<sup>200</sup> Proving a negative is never desirable, and it does not make sense to force an insured to do so, whether in the minority of jurisdictions that follow the aforementioned rule or under the new New York regime.<sup>201</sup>

To some extent, the entire shifting of the allocation of the burden of proof seems needlessly complicated. Only one other state—Wisconsin—uses a similar burden-shifting scheme in the late-notice context.<sup>202</sup> It seems far simpler to adopt the traditional version of the notice-prejudice rule under which if notice is late, the insurer has the burden to show that it was prejudiced, and only if it meets that burden can it then disclaim coverage.<sup>203</sup> Under this simple version of the rule, the insurer always has the burden, which, as noted, is desirable for several reasons.<sup>204</sup> Such a “clean” notice-prejudice rule is followed in the majority of states.<sup>205</sup> In fact, in *Brandon*, this simple notice-prejudice rule was exactly what the

198. 769 N.E.2d 810, 815 (N.Y. 2002) (applying the notice-prejudice rule to SUM insurance claims where notice of claim was timely but notice of suit was late).

199. See 22 HOLMES, *supra* note 2, § 139.4(C)(1)(b) (citing cases from Connecticut, Florida, Indiana, Iowa, Ohio, Tennessee, and Wisconsin (presumption of prejudice in Wisconsin arises when notice is more than one year late)).

200. See, e.g., *Campbell v. Allstate Ins. Co.*, 384 P.2d 155, 157 (Cal. 1963) (en banc) (“Although it may be difficult for an insurer to prove prejudice in some situations, it ordinarily would be at least as difficult for the injured person to prove a lack of prejudice, which involves proof of a negative.”); *State Farm Mut. Auto. Ins. Co. v. Johnson*, 320 A.2d 345, 347 n.3 (Del. 1974) (“It seems both more practicable and more equitable to require the insurer to establish prejudice.”).

201. See *Jones v. Bituminous Cas. Corp.*, 821 S.W.2d 798, 803 (Ky. 1991) (“There are two reasons for imposing the burden on the insurance carrier to prove prejudice, rather than imposing on the claimant the burden to prove no prejudice resulted. The first is the obvious one: it is virtually impossible to prove a negative, so it would be difficult if not impossible for the claimant to prove the insurance carrier suffered no prejudice. Secondly, the insurance carrier is in a far superior position to be knowledgeable about the facts which establish whether prejudice exists.”). As the *Jones* court added, “Indeed, it is difficult to imagine where the claimant would look for evidence that no prejudice exists.” *Id.*

202. See WIS. STAT. ANN. § 631.81 (West 2004 & Supp. 2007); *Neff v. Pierzina*, 629 N.W.2d 177, 185 (Wis. 2001).

203. Cf. *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 844–46 (Ct. App. 1993).

204. See, e.g., *Jones*, 821 S.W.2d at 803.

205. 22 HOLMES, *supra* note 2, § 139.4(C) (“In an overwhelming majority of states, an insurer may not raise the failure of an insured to give notice as a valid defense to its obligation to prove coverage under an insurance policy, *unless the insurer can demonstrate prejudice from the insured’s failure to comply with the policy’s notice provisions.*” (emphasis added)).

New York Court of Appeals chose to adopt in the SUM context.<sup>206</sup> It seems odd to not follow the guidance of the high court, or of any court for that matter.

Adopting the simple, traditional rule in New York would streamline late notice litigation two ways. First, it would eliminate litigation related to determining which party bears the burden of proof. Second, it would alleviate insureds from the difficult position of having to prove a negative if notice was received more than two years late. As currently written, the system of shifting burdens of proof is likely to prove burdensome both to courts and litigants, and it should be changed.

### 3. *What Is Prejudice?*

The definition of prejudice is no doubt going to be another area subject to extensive litigation.<sup>207</sup> Under chapter 388, prejudice is that which "materially impairs the ability of the insurer to investigate or defend the claim."<sup>208</sup> This is a new standard in New York, and courts will have to define the bounds of this term and create a body of case law addressing it.<sup>209</sup> In attempting to define "materially impairs," New York courts are likely to look to the laws of other notice-prejudice states and their courts' precedent in defining similar terms and concepts.

In notice-prejudice states, there are several variations as to what type of proof of prejudice is required.<sup>210</sup> Articulated tests include: "actual prejudice,"<sup>211</sup> "prejudice in fact,"<sup>212</sup> "serious impairment of investigation or defense,"<sup>213</sup> "substantial prejudice,"<sup>214</sup> "material prejudice,"<sup>215</sup> and

206. *Brandon v. Nationwide Mut. Ins. Co.*, 769 N.E.2d 810, 815 (N.Y. 2002).

207. See DeFrancisco & Weinstein Letter, *supra* note 111 (addressing concerns over the use of "material prejudice" in the 2007 version of the bill and noting that "there is almost always going to be litigation concerning the meaning of such key words in a bill"); see also Prejudice, Presumptions, and Burdens of Proof, <http://nycoveragecounsel.blogspot.com/2008/06/prejudice-presumptions-and-burdens-of.html> (June 14, 2008, 10:50 am) ("Expect litigation over and court interpretation of what constitutes a 'material impairment'. The use of the qualifying adverb 'materially' probably means that not all impairments will sustain a late notice disclaimer. My vision is impaired, but I can wear contacts or glasses to correct it, so is my impairment material? In other words, *how much* of an impairment of either an insurer's investigation or defense will be enough to rise to the level of being 'material'?").

208. N.Y. INS. LAW § 3420(c)(2)(C) (McKinney 2007 & Supp. 2009); 2008 N.Y. Laws ch. 388, 1090-91.

209. See Bennett & Zimmerman, *supra* note 18 ("In all likelihood, the next late notice battle in New York will be over how concretely carriers must articulate the 'impairment' of their investigation or defense of a claim and, similarly, how likely it was the lost opportunity to investigate or defend would have borne meaningful fruit.").

210. See 13 RUSS & SEGALLA *supra* note 4, § 193.50.

211. See *Weaver Bros., Inc. v. Chappel*, 684 P.2d 123, 123-26 (Alaska 1984).

212. See *Barnes v. Lumbermen's Mut. Cas. Co.*, 308 So. 2d 326, 326-28 (La. 1975).

213. See *New Eng. Extrusion, Inc. v. Am. Alliance Ins. Co.*, 874 F. Supp. 467, 467-70 (D. Mass. 1995).

214. See *Nw. Title Sec. Co. v. Flack*, 85 Cal. Rptr. 693, 693-97 (Ct. App. 1970).

215. See *Lighter v. Lumbermens Mut. Cas. Ins. Co.*, 683 N.E.2d 297, 299-300 (Mass. App. Ct. 1997).

“appreciable prejudice.”<sup>216</sup> Which of these tests the New York courts should adopt is debatable. Despite the facial similarity of these tests, they are each nuanced in their own way, and as they are all different from the articulated New York test, wholesale importation would be impossible.

In order to find the proper standard, New York courts should try to glean a legislative intent from chapter 388. In furtherance of that goal, a letter written to the Governor by the 2007 version’s sponsoring legislators is illustrative even though it discusses “material prejudice” and not “materially impairs”:

It must first be noted that this phrase [material prejudice] was originally suggested in an attempt to ameliorate the concerns of the insurers during the drafting process, it having been felt that this was a slightly lesser standard than “substantial prejudice,” as the original draft of the bill contained. Because we saw the two standards as virtually identical in practice, we agreed to such a modification.<sup>217</sup>

Despite this passage describing a different version of the bill, the articulated belief that “materially” is ever so slightly a lesser threshold than “substantially” will be beneficial to courts looking to define prejudice. A reviewing court should draw upon this subtle difference between material and substantial as articulated in the above-quoted passage and then review cases from other states to find a suitable definition for materially impairs within the new law in New York.

Another problem in developing substantial case law to define what constitutes material impairment is that “what constitutes prejudice to the insurer and whether there has been material impairment of the insurer’s ability to defend or investigate a claim . . . often turn[s] on the facts” of each case.<sup>218</sup> Thus, each ruling might have limited precedential value in subsequent cases. Though these growing pains are normal, it may take years for a sturdy body of case law to develop that is capable of defining “materially impairs” sufficiently enough to provide a shared understanding of the law by courts and litigants.

#### 4. *Retroactivity of Chapter 388*

According to the Circular Letter released by the New York Insurance Department, chapter 388 is not retroactive in its effect, and it only applies to policies issued on or after January 17, 2009.<sup>219</sup> Even in light of this clear statement, there are and will continue to be debates over the law’s retroactive application.

Despite its explicit language that the new notice-prejudice provisions only apply to policies issued after January 17, 2009, “[p]olicyholders will quickly point out the obvious—the New York

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216. See *Fed. Ins. Co. v. Purex Indus., Inc.*, 972 F. Supp. 872, 882 (D.N.J. 1997).

217. DeFrancisco & Weinstein Letter, *supra* note 111.

218. Epstein & Keys, *supra* note 13.

219. Letter from Larry Levine to All Authorized Prop./Cas. Insurers et al., *supra* note 22.

Legislature has sent a clear message that forfeiture of coverage based on late notice technicalities should no longer be the law in New York."<sup>220</sup> Though this argument is likely to fail, it does not mean that litigants will not make it or that no New York court will follow it. Since chapter 388's passage, several courts addressing late notice in New York have explicitly or implicitly pointed out that the law is not retroactive in effect.<sup>221</sup> Even more interesting, at least two litigants have specifically argued that chapter 388 is in fact retroactive based on the legislature's clear statement of policy.<sup>222</sup> In one of these cases, the insured successfully convinced the trial court that because of chapter 388, its insurer could only disclaim coverage if it was prejudiced by the insured's failure to provide timely notice.<sup>223</sup> This erroneous decision was reversed on appeal.<sup>224</sup> Expect similar attempts in the future.

Beyond the above attempts to make the law retroactive in a standard late-notice case, there could be a tremendously difficult problem in the future with the treatment of late notice in a continuous-exposure situation. Imagine a hypothetical—which would conceivably happen<sup>225</sup>—where a chemical plant located in New York has a continuous-exposure injury. From 2000 until 2019, the plant unknowingly leaks toxic chemicals into the surrounding groundwater and slowly poisons the local community. Throughout this period, the plant has primary and excess liability policies issued by several different insurers. Obviously some are issued prior to 2009, while others are issued afterward (meaning that some would be subject to chapter 388 and the notice-prejudice rule while others would not be). Now imagine that for whatever reason, the plant does not provide timely notice to the insurers but that not even one of the insurers was materially impaired (prejudiced) by the late notice. Furthermore, notice is provided within two years of the time required by the policy, so at least for the policies subject to chapter 388, the burden to show prejudice is on the insurer.

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220. Bennett & Zimmerman, *supra* note 18.

221. See, e.g., *Safeco Ins. Co. of Am. v. Discover Prop. & Cas. Ins. Co.*, No. 05 Civ 8625, 2009 U.S. Dist. LEXIS 18735, at \*5 n.3 (S.D.N.Y. Feb. 23, 2009); *Briggs Ave. LLC v. Ins. Corp. of Hannover*, 899 N.E.2d 947, 949 (N.Y. 2008); *Am. Safety Indem. Co. v. 612 Realty LLC*, No. 600347/2004, 2009 WL 2407822, at \*2 (N.Y. Sup. Ct. Aug. 4, 2009)

222. See *Travelers Cas. & Sur. Co. v. Dormitory Auth.*, No. 07 Civ. 6915, 2008 U.S. Dist. LEXIS 87449, at \*7 (S.D.N.Y. Oct. 29, 2008); *Sevenson Envtl. Servs., Inc. v. Sirius Am. Ins. Co.*, 883 N.Y.S.2d 423, 425 (App. Div. 2009).

223. *Sevenson*, 883 N.Y.S.2d at 425.

224. *Id.*

225. For examples of late-notice discussions on the risk throughout the period of loss in the context of continuous-exposure liability incurred over long periods of time with multiple insurers, see *Canadyne-Georgia Corp. v. Continental Insurance Co.*, 999 F.2d 1547, 1554–57 (11th Cir. 1993), and *Aetna Casualty & Surety Co. v. Dow Chemical Co.*, 10 F. Supp. 2d 800, 810–15 (E.D. Mich. 1998). *Aetna Casualty v. Dow* found that some insurers were prejudiced as a result of the late notice while others were not. See *id.*



What is a court to do?<sup>226</sup> How can it apportion liability among the policies if the pre-2009 policies were free to use the no-prejudice rule, while the post-2009 policies were subject to the notice-prejudice rule and have clearly not been prejudiced? Despite the strong wording that chapter 388 is not retroactive, a situation such as this might lead a court to rule otherwise. If damages are in the hundreds of millions of dollars this decision will have huge consequences for all parties involved.

### CONCLUSION

Chapter 388 represents a monumental change for the State of New York. For far too long the state applied a rigid no-prejudice rule when notice to insurers was untimely. The results of this application were anything but fair. The change in the law is welcome and long overdue; however, it is not without its own issues and shortcomings.

There are likely to be a number of highly litigated provisions in chapter 388. New York courts will have many difficult questions to answer. Beyond that, with regard to certain aspects of the law, the New York Legislature might even need to enact additional legislation to remedy the gaps and problems that were created by chapter 388. But the real importance of this legislation will likely be beyond the borders of New York. As the champion for and advocate of the no-prejudice rule, New York led a minority of jurisdictions in its application. However, without the leadership and support of New York, it is likely that the remaining jurisdictions that apply the no-prejudice rule will soon stop doing so. It will likely take time but, as New York insurance law goes, so goes the country.

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226. At least one pair of commentators does not think success is likely in this scenario. See Bennett & Zimmerman, *supra* note 18 (“[T]he law may have no effect on the ‘no-prejudice’ rule as it relates to long-tail liabilities involving historical policies.”).